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ABSTRACT

Based on the view that tuition tax credits will benefit all taxpayers, this report examines the history and economics of educational financing to furnish a background for an explanation of current proposals to provide tuition tax credits. The author begins with five theoretical economic models of school finance designed to explain the logic of tuition tax credits. The report then looks at several historical models of school finance including the New York public school system and the economic bases for free and for compulsory schooling. The rationales for current proposals to establish tax credits are then examined and some criticisms of tuition tax credits are refuted. The report then makes a case for a potential gain for taxpayers from education tax credits based on the contention that they will generate competition throughout the school system and bring down the cost of education. Early origins and recent federal proposals for tax credits are then examined, including Tom Paine's education tax credit system, U.S. federal tax credit and tax deduction schemes until 1977, the Packwood-Moynihan Proposal, and the 1979 tuition tax credit bill. The report concludes with descriptions of education tax credit proposals in California and Washington, D.C., and a comparison of tax credits and vouchers. (Author/JN)

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Introduction

In January 1981, President Reagan's first address to Congress included a reference to his administration's interest in tuition tax credits. Meanwhile, the coalition that fought for the Packwood-Moynihan Tuition Tax Credit bill two years previously is preparing a new bill for Congress. Equally interesting is the fact that the National Taxpayers Union, which had been working for a constitutional referendum on its tax credit proposal in California, suddenly switched its efforts to the District of Columbia. A Committee for Improved Education there is now in the process of introducing an initiative for Educational Tuition Tax Credits for a November 1981 election.

These facts alone call for a careful evaluation of tuition tax credits in general and an analysis of particular proposals, including those above—hence the present study.

Any assessment of tax credits for education in America will depend upon presumptions about family responsibility, judgements about the relative effects on the poor compared with the rich, and assessments of possible conflicts with the Constitution.

Consider the constitutional issue first. Views on this depend, it seems, upon one's opinion whether the Supreme Court's deliberations have yet been finalized. While one U.S. attorney general has offered the formal opinion that the tuition tax credit for private elementary and secondary schooling is definitely unconstitutional, a past assistant attorney general has, in contrast, advised that:

It is impossible, within the time allocated, to describe with any completeness the utter confusion of Supreme Court pronouncements in the church-state area....I urge you, then, to approach this issue as a question of what "should be" rather than vainly seeking to determine what "is" under the decision of the Court.¹

Because there are so many different aspects of the tax credit proposal, it will be helpful to proceed step by step from simple to more complex and realistic illustrations. Such an exercise is intended gradually to illuminate the scene so that people may judge the *normative* issues (of what *should be*) more clearly for themselves. There will then remain the issue of *positive* analysis (of what is, and what probably

¹Quoted in Daniel P. Moynihan, "The Case for Tuition Tax Credits," *Phi Delta Kappan* 60, no. 4 (December 1978).

will be). Its application will enable us to explore the actual chances of tax credits succeeding in the real world regardless of any one individual's personal preferences.

Models and Systems

Model 1

The first illustration or model is one of a democratic community of one thousand families, each containing one child of school age. Suppose identical preferences (tastes) prevail and each and every family enjoys an income of \$20,000 per annum. Assume that there is no government intervention in education as we know it today. Each family spends, say, \$1000 per year on private schooling of its choice so that the *total* expenditure on schooling is \$1 million. Government has one major "public good" responsibility: defense. This is financed exclusively from a proportionate income tax of 10 percent to cover the total cost of defense of \$2 million.

In this scenario, and to most people, there will apparently be no question of the operation of any form of "tax credit" for education. Yet, strange as it may seem, there are some who would indeed view the situation as a tax credit scheme, or, in terms of some recently created terminology, as a tax *expenditure* scheme.

Their reasoning would be as follows. There are two basic ways in which governments may utilize their revenue-raising powers. First they can use the funds collectively to purchase goods and services (like defense). Second, governments can provide assistance, encouragement or relief to private-sector activities through concessions in the tax system. The government provides the assistance or relief by foregoing tax revenues. This "act" of undertaking "tax expenditures," so the argument goes, is equivalent to making indirect expenditure through the fiscal system.

The new term "tax expenditures" was coined by Assistant Treasury Secretary Stanley S. Surrey in the late 1960s. He deduced that most of the tax deductions, exclusions, exemptions, and credits are the equivalent of public expenditures for the "recipients." He insisted indeed that they are so important as to be treated as public expenditures to be subjected to the same type of annual review by Congress and the Executive as conventional expenditures. Developing a "tax expenditure budget," Surrey estimated it to total between \$42 and \$45 billion for

the fiscal year 1968. These amounts, in other words, were the foregone revenues of the government in that period.

Clearly the size of this budget depends on who is constructing it and what he deems to be the extent of foregone government revenue. At one limit the extremist might insist that the whole of the national income was potential revenue for governments and that any of it that was enjoyed privately by individuals was the result of a decision by government not to tax in the instances in question. It is in this sense that the situation in our first model might be described by the extremist as a tax credit scheme.

The tax expenditure concept thus described has been enjoying a flourishing life ever since Surrey's introduction of it. Further testimony to the popularity of the idea is seen, for instance, in the once expressed view of a previous Ways and Means Committee Chairman, Wilbur Mills, that all tax concessions are "a form of backdoor spending." Subsequently tax concessions have been called *tax subsidies*. And indeed they subsequently have been included in studies of federal subsidy programs.

Much of the tax expenditure thinking is reflected in the tax reform movement that focuses upon a demand to "close tax loopholes." So, clearly the decision to use the terminology of tax expenditure and the urge to close loopholes is, to a large extent, a reflection of an individual's own political philosophy and it is not surprising that the subject has given rise to considerable controversy.

Critics of the concept Paul Craig Roberts and Richard E. Wagner² have argued that a self-interested government, ambitious for further expansion, would use the language of tax expenditures as tax loopholes to create the impression that the tax system is biased in favor of certain groups. When the loopholes are closed and the "fringe benefits" are successfully taxed, these benefits are then discouraged from being privately supplied. Simultaneously, there is created a demand that these benefits be provided by government. Expansion in the share of income that is provided in-kind by government will then increase its power *vis à vis* the governed.

So much for our first application of the tax expenditures (tax credits) philosophy to our model of a community of 1000 families with its special assumptions. Although it has been an extreme case, the exercise has been useful because, on reflection, it reveals a vision of society that is incompatible with the kind of democracy set up under the American Constitution. For, if all of the national income was to be deemed by the government to be in common ownership, then the First Amendment that decrees no aid to religion would be academic. Any

²Paul Craig Roberts and Richard E. Wagner, "The Tax Reform Fraud," *Policy Review* No. 9, Summer 1979.

appearance of religious education would immediately be condemned as infringing the Constitution. The complaint would be that it was financed by money that "belonged to" the public sector. The situation would thus automatically be interpreted as aid to religion. The Separation Clause in the First Amendment would then, in effect, be a "wall of exclusion," not a wall of mere "separation."

Curiously enough, the deliberations of the Supreme Court in recent years have come perilously close to expressing the language in such loose terms that would suggest a presumption that government does "own all income." From the tone of the Supreme Court's verdicts one often gets a judicial view of the state as an entity that is independent of the individuals in society and one that enjoys a tax-finance income (called "public funds") that is equally detached or "disembodied."

Consider for instance the argument of the Court in the *Nyquist* decision of 1973. It struck down New York's planned system of tax exemptions because

In practical terms there would appear to be little difference for purposes of determining whether such aid has the effect of advancing religion, between the tax benefit allowed here and the tuition grant The only difference is that one parent receives an actual cash payment while the other is allowed to reduce by an arbitrary amount the sum he would otherwise be obliged to pay over to the State."

There is a tacit belief in the above quotation that the Court knows precisely what proportion is so owned, or commandeered, and it is not clear that it is anything less than 100 percent. The last sentence in the quotation simply refers to the sum that the individual would "otherwise be obliged to pay over to the State." The Court clearly has no authority to make such a statement. In a democracy the pattern of tax obligations to the State is decided by voters; there is no mechanical way of predicting the outcome of that decision, and tax obligations can be allowed by democratic governments to vary over time between groups in a way that no court can have advance knowledge.

Model 2

Our second elementary model is obtained by one simple adjustment to the first. Suppose now that only one half of the population of one thousand families have children (i.e., two children each). Assume, too, that the proportional tax rate is now 15 percent but there is a standard tax deduction per dependent child of school age of \$1000. Recalling that incomes are \$20,000 per annum, this means that 500 families without children will pay \$3000 each in tax and 500 with children will pay \$1000 each. The total tax proceeds still are \$2 million to provide for the same size defense budget as before.

The \$2000 deduction per child is made available to secure what is

thought to be horizontal equity between taxpayers. Those with family responsibilities to feed, clothe and educate children are thus charged a lower tax price for the government service (defense), while others face a correspondingly higher tax price. There is no meaning to the proposition that the child allowances are tax expenditures in the sense of government revenues *foregone*. Since the government obtains the same total revenue of \$2 million for defense, the change from Model 1 to Model 2 involves *no* foregone revenue to meet its (fixed) obligations. All that has happened is a change in relative "tax prices" facing different groups of citizens. And insofar as a family spends some portion of the \$2000 on its child's education it cannot be claimed that this is a kind of tax credit that is equivalent to "aid from the state." Neither does the money come from some entity called "public funds"; for at no point did it enter into the government's financial circuit either in reality or conceptually.

Model 3

In our third model we relax the assumption of equal incomes but maintain the condition of equal (homogeneous) preferences. If the government maintains the view that "tax prices" for the government service (defense) should be inversely related to responsibilities to dependents, it may be able to make its system of tax deductions so flexible and adaptable to individual family circumstances that there will be no requirement for special "in kind" policies.

Where the pressure on the lowest income families with children is particularly severe, the precise cause of the financial difficulty will be relevant for further government action. It may be that incomes happen to be low because the parent is young and at the earliest stage of a life cycle of income that is expected to grow through time. With perfect capital markets he could borrow by pledging his future (higher) income. Where capital markets are imperfect a government could consider a system of lower taxes now to be compensated by correspondingly higher ones in the future. Tax *credits* could then be given in the present, but only on the understanding that tax debits would offset them in the future.

In some circumstances the tax credits could be below zero, as in the case of the adoption of the negative income tax. Instead of paying taxes the family would then receive funds (negative taxes) from the government, so long as it was earning below some stipulated sum.

It may be objected that once the rules are so designed many individuals will take unfair advantage of them. Some families, for instance, may devote their negative income taxes disproportionately to non-child expenditures. Others may have more children than originally planned because of the reduced cost of child-rearing. Notice, how-

ever, that the latter "moral hazard" problem (as it is called) is common to *any* system of "pro-child" legislation. Sometimes there may be, as in the Canadian province of Quebec today, a deliberate political *intention* to encourage population growth.

With respect to the first moral hazard problem of insufficient expenditure by parents on the child, this is less serious in our model because we have assumed that tastes are the same across individuals, and only incomes vary. But at the same time society can still rely on child abuse laws to deal with any hard cases. And this is the method largely relied upon currently with respect to the feeding and clothing of children.

Observe once more that although some families in the model are enjoying tax credits and deductions, there is no assumption that their private child-service expenditures are financed by "public funds." Parents receiving tax credits might purchase education from church schools. But there can be no infringement of "First Amendment Laws" any more than when they purchase food or clothes from church-sponsored organizations.

So far nothing has appeared that can be called an "education policy"—any more than there can be a child feeding, clothing, or housing policy. Education has not been made "free." And, indeed, insofar as any argument is made in favor of "free" education it is difficult to see why it should not be joined with a policy of "free" food, clothing, and housing of children.

Model 4

In our fourth model we drop the assumption that people and their tastes are similar and assume that our population is very mixed in terms of ethnic origin, "classes," and aspiration. Some may now argue that it is desirable that the student population in each school should be reasonably representative of the individuals in the community. Others may take the contrary position that plurality and diversity are the most worthwhile social objectives.

If the upholders of the first view predominate, the question arises as to the most appropriate public policy. If there is a "First Amendment Law" one problem immediately asserts itself. Such law precludes government action that prohibits religion. Those who insist on the greatest population "mix" in schools would presumably wish them to contain representative proportions of Catholics, Protestants, and other denominations. But since this could hardly be done without severely emasculating the nature of church schooling as it normally exists, there would be serious danger of "prohibiting religion" to a significant degree.

Suppose that despite this problem an "education policy" appears for

the first time and with the intention of promoting a more homogeneous population. One method is decided upon to attempt to achieve the desired objective. It is to provide equal access public schools and a "free" education in these institutions only.

There is one major problem. It stems from the fact that the innovation presents church school families, as well as others, with a new opportunity: the service of schooling free of charge at the public school. In deciding whether to continue to send his child to the church school at the same positive price (tuition), the parent now has to realize that if he does continue as before he foregoes the new opportunity of a "free" schooling. In economics the "foregoing of an opportunity" is the very essence of *cost*: and, indeed, economists generally speak of "opportunity costs." But since the new situation has confronted the denominational parent with a cost, the effect is to prohibit religion, at least in degree, and this is unconstitutional.

It should be remembered that the new scheme of "free" public schools will call for increased taxes on *all* families, including those who support religious schools. They now have to pay twice when they continue to select their customary church school: once for their own school and once, through taxes, for the public system. Only if such private school users were excluded from the tax contributions to the "free" public schooling would the infringement of the First Amendment be avoided.

A tax credit to private school users to offset the disadvantage might be a more practical method of accomplishing the same thing. But, as we have seen, legal opinion is divided on whether the Supreme Court would countenance such an arrangement. One of the difficulties is that the tax credits would go only to one section of society (others having offsetting "free" public school advantages). The benefiting section of society will be largely users of church schools and this might give the appearance of aid to religion even though, in fact, it is only an offset to a government-induced *prohibition* of religion.

The social objective of pursuing a more homogeneous society is in most democracies not likely to be completely absolute and unyielding. If the objective was absolute, the most direct way of accomplishing it would be to completely outlaw private schools. The fact that this solution is irreconcilable with the American Constitution was endorsed when the Supreme Court frustrated it in *Pierce v. Society of Sisters*³ over a half a century ago. Even in the absence of this famous case it is doubtful whether majorities could ever exercise sufficient political power to make private schooling illegal. Minorities, especially substantial ones such as Catholics, always have *some* political influence, especially where vote trading is feasible. But, in any case, to the aver-

³286 U.S. 540 (1925)

age (median) voter the precise trade-off between the two objectives of population homogeneity (the "melting pot" philosophy) and plurality-plus-diversity is likely to be a constantly shifting one. Only by coincidence will the balance of preferences call for exactly 100 percent subsidy for public schools (i.e. "free" schooling).

Model 5

Suppose then that in our fifth model the median voter calls for a subsidy of $66\frac{2}{3}$ percent of the costs of public schooling and the opportunity costs imposed on church school parents are a consequence of the political weight of the majority. The judiciary meanwhile is unwilling to obstruct the policy. This would mean that "free" education would be abolished since users of public schools would have to pay tuition equal to one third of the total cost per child. In this case those who continued to use church schools would still "pay twice" but the opportunity cost of foregoing the subsidized public school would not be so high as when access to it was free ($66\frac{2}{3}$ percent compared with 100 percent subsidy).

This scenario is clearly a compromise between Models 3 and 4. And, in the former, tax credits prevailed without any shadow of infringement of the Constitution. So, in the present model, society could with impunity have a system of tax credits corresponding to the sum required for one third of the public education cost per child. For in this case, unlike Model 4, tax credits would be *universally* "spent" by public school users as well as by private school users, and in identical dollar amounts. The finding is then that tax credits are unambiguously feasible so long as parents in public schools have to pay some direct costs such as tuition. This point will be shown later to be a crucial factor in the debate. It follows, meanwhile, that advocates of tax credits should simultaneously favor positive prices in public schools; or, alternatively expressed: less than 100 percent subsidies.

Historical Relevance of the Models

So far we have been studying models of society that have been deliberately designed to be consistent with consciously adopted social objectives. In other words, we have been studying "what ought to be," given certain generally accepted values. It is now time to approach the question of tax credits from the point of view of *positive* economic analysis. This focuses upon descriptive statements, propositions, and predictions about the real world. For instance, an economic model may predict that the price of timber will increase 10 cents a pound if incomes per head rise by 10 percent. Positive economics "predicts" in this same sense. It is concerned with postulating what *will* happen under given circumstances. Unlike normative economics it says nothing about whether the results are good or bad or about what we *should* do.

Public Choice Predictions

It will next be helpful to apply what has come to be called public choice analysis. Public choice is a study of non-market decision-making, or the application of economics to political science.⁴ The *subject matter* is the same as that of political science and includes the theory of the state, voting rules, voter behavior, party politics, and bureaucracy. The methodology, however, is that of economics, the assumed basic behavioral postulate being that man is an egoistic, rational, utility maximizer.

Public choice analysis does not begin with pre-conceived notions of an economy governed by philosopher-kings who are to achieve "social optimality" by way, for instance, of the "perfectly designed" models explored in the preceding section. It starts with the realistic recognition that governments, for some not particularly obvious reason, have taken over the supply of schooling in the real world even though education can be technically described in economics as being largely a *private* good, that is, a good which is pursued primarily for private (family) as distinct from social (public) benefit.

Once within the enclave of government supply, the public choice

⁴Dennis C. Mueller, *Public Choice* (Cambridge: Cambridge University Press, 1979).

analyst of education must focus, among other things, upon the economics of the public bureaucracy and the special interest group that supplies education generally. The latter, of course, comprises teachers and administrators, both of whom are represented by powerful unions.

But positive economics is also concerned initially with accurate fact, description, and history. It is necessary, therefore, first to enquire how realistic the models in the previous section are as statements of the real world historical evolution of educational supply.

The Origin of the New York Public School System

The first model outlined in the previous chapter was of a society of equals purchasing education privately. It abstracted from historical reality mainly in its assumption of equal incomes. But once we drop this assumption we are left with a model that does, in fact, roughly correspond to the real world at one point in U.S. history immediately prior to government intervention.

In those days it was typical for most American families to purchase education privately at positive tuition charges. This is a subject on which there is often considerable obscurity and ignorance. Many people tend to believe, for instance, that before the government-provided system of education, schooling for the masses did not exist. This is untrue. To show why we shall briefly examine the 19th century evidence of one state, New York, especially since its experience seems to have been fairly typical of others at the time.⁵

Commissioners were first appointed to consider the establishment and organization of Common Schools in New York State in 1811. To justify such schools it was necessary to establish in what respects the people were not already securing sufficient education for their children. The Commissioners found that schooling was indeed already widespread. They concluded that it was "generally resorted to, unless some great local impediments interfere."⁶ By "local impediments" the Commissioners largely meant obstacles to the minority of the population that was thinly scattered in rural areas.

In populous cities, and the parts of the country thickly settled, *schools are generally established by individual exertion*. In these cases, the means of education are facilitated, as the expenses of schools are divided among a great many. It is in the remote and thinly populated parts of the State, where the inhabitants are scattered over a large extent, that education stands greatly in need of encouragement. (my italics)

⁵The following section draws heavily upon my article: "The Political Economy of Public School Legislation," *Journal of Law and Economics*, October 1967, reprinted as Studies in Education No. 4, Institute for Humane Studies, 1977.

⁶Randall, *History of the Common School System of the State of New York* (1871), p. 18.

The situation was thus presented in the same terms as those later to be used in England by W. E. Forster, the architect of the 1870 English Education Act; it was largely a problem, to use Forster's words, of "filling up the gaps" in the nearly universal system of fee paying private schooling for *all* classes.

The New York Report of 1811, having stressed the plight of the rural areas, leads the reader to expect special attention to be paid to them in the general scheme of intervention. No such priority subsequently appeared, however. The main features of the plan suggested by the Commissioners were: that the several towns of the state be divided into school districts by the Commissioners elected by the citizens to vote for town offices; that three trustees be elected in each district, to whom shall be confined the care and superintendence of the schools to be established therein; that the interest of the school fund be divided among the different counties and towns, according not to the distribution, but to the size of their respective populations as ascertained by the current census of the United States.

Thus, in place of discrimination in favor of poor and thinly populated districts, which was the only relevant remaining need according to the evidence, a flat equality of treatment was decreed for *all* areas. Each town, at its own discretion, was to raise by tax, annually, as much money as it received from the Common School Fund.

One important feature in the early Common Schools that is often forgotten is that they did *not* receive 100 percent subsidies. That is, they were not "free." For this reason the situation in New York between 1812 and 1867 parallels that sketched out in our Model number 5 in the last chapter.

Pointing out that the public money alone would never be adequate to maintain the Common Schools, the Commissioners of 1811 observed:

But it is hardly to be imagined that the Legislature intended that the State should support the whole expense of so great an establishment. The object of the Legislature, as understood by the Commissioners, was to rouse the public attention to the important subject of education by adopting a system of Common Schools in the expense of which the State would largely participate, to bring instruction within the reach and means of the humblest citizen.⁷

Even with the addition of the revenues from the town taxes there were far from sufficient funds to cover expenses. The substantial balance was presented as tuition charges in the form of so-called rate bills to the parents. They were required in fact to pay in proportion to the attendance of their children. These parental charges were quite signifi-

⁷Randall, p. 21.

cant. In 1830, for instance, parental fees contributed \$346,807 toward the total sum for teachers' wages of \$586,520.

On the *quantity* of education the Report of Superintendents for 1836 asserted:

Under any view of the subject, it is reasonable to believe, that in the Common Schools, private schools and academies, the number of children actually receiving instruction is equal to the whole number between 5 and 16 years of age.⁸

The fact that early 19th century education in America could continue to be universal without being free, and without compulsion, seems then to have been readily acknowledged at the time. And there is no systematic evidence to show that average parents, as distinct from public school teachers and administrators, preferred the method of paying for schooling through increased taxes to that of the direct payment of tuition through rate bills. Private schools in this period, as today, amounted to around 10 percent of the total school population. As in our Model 5, therefore, it would have been appropriate, and constitutional, to allow tax credits that covered both private school and common school fees. There could have been no question *then* of any discrimination in favor of religious (private) schools.

The Origin of "Free" Schooling

So much for the description of events in New York in the 19th century. The task of positive economics is next to explain the gradual modification of the Common School system there from 1867 to the present, a modification that grafted on to the system two important new features: (a) 100 percent subsidies ("free" education), (b) compulsion.

First consider the simplest proposition in the economics of politics. We start with the postulate that every government seeks to maximize political support and accordingly seeks to be constantly informed about the wishes of the majority of voters. Second, in the real world, the existence of uncertainty creates barriers to communication. On the one hand it is costly for government to keep constantly in touch with voters; on the other hand, the electorate is not fully aware of all the issues. Such a situation is favorable to the emergence of special interest groups claiming that they are the representatives of the popular will. Propaganda put out by them will serve to create real public opinion at the same time that it attempts to persuade the government of the existence of such opinion.

Producing political influence is a particularly costly operation and the costs will be assumed mainly by those who stand to gain most from

⁸1836 Annual Report New York's Superintendent of Common Schools 8.

it. For instance, those individuals who work in a service that is provided by government can, especially through their unions, afford to bring greater-than-average influence to bear upon government policy since their incomes will be particularly responsive to it.

In contrast, the consumers, having interests that are spread over many products and services, cannot so easily afford to buy influence over the supply of only one of them. In particular, they will not be able to afford the information necessary to evaluate the full implications of government policy such as, for example, the true incidence of taxation necessary to pay for "free" services or the eventual effects of "free" service upon consumer choices.

It is merely an extension of these observations to suggest that teachers, through their unions or associations, will promptly be energetic in the political arena whenever the political process suddenly provides one of the easiest routes to economic gain. It so happens that in the late 1840s the New York teachers and administrators of education became the leading instigators of the campaign to abolish the rate bills and make education "free."

Like most other individuals in society, teachers will tend to attempt to make a monopoly of their profession whenever the opportunity arises. The benefits of monopoly are higher salaries and/or a reduction of effort on the job. Where parents pay direct fees or rate bills this money goes with them whenever they decide to transfer their child from a Common School to a private one. It is this force of competition that makes suppliers of education attentive to parental preferences. The moment such competition ceases the relative power of parents declines dramatically.

Where, for instance, the fees are zero, then the decision to transfer a child to a private school does not automatically transfer funds. Moreover, where a public system is selling its service free, it is difficult, if not impossible, for a private system to survive. This means that there are usually very few alternatives for parents to choose, so that they tend to become locked into a zero-priced public system which becomes a monopoly, the benefits of which accrue to the supply interests such as teachers and administrators.

A simple extension of the same reasoning suggests that, once it is behind them, the teachers' and administrators' unions will attempt to conceal the historical fact of a once universal fee paying system for all income groups. Furthermore, they will be at the forefront of any modern attempts to return to direct fee paying.

Self-interest would have dictated to the Common School employees and organizers that the best course in the 1830s and 1840s was to campaign for a 100 percent subsidized, that is, a "free" school system, in order that the last traces of customer discretion be removed. Teachers

in private schools stood to lose whenever the contest was transferred to the political arena since they were in a minority in the profession as a whole. Moreover, the public school teachers had allies in the form of the growing body of administrative personnel that had a direct interest in the expansion of public school districts.

In historical fact, organized teachers in the 1840s were the chief campaign leaders in the movement to abolish the rate bills and to make education "free." All kinds of expedient arguments were enlisted. And it was at this time that a new note appeared in the controversy. It was now contended that the purpose of public schooling was not just to ensure an acquisition of literacy and knowledge but also to encourage a more homogeneous population—the argument that we investigated above when discussing our Model number 4 in Chapter 2. One of the first examples of it was the proposition that the children of the rich need to be integrated with those of the poor. This is the way the bureaucracy and the organized teachers expressed it:

If all the schools of every grade that the State to any extent supports were associated in one homogeneous system, and the appropriations of the State were confined to that system as heretofore recommended by this Department, and as repeatedly urged by the State Teachers' Association, there would be no ground for conflict.⁹

The rate bills (fees) were finally abolished with the passing of the Free Schools Act of 1857. This led, predictably, to a check in the growth of education in private schools. Indeed by 1870 the Superintendent of one county could observe with satisfaction:

Private schools, always exerting, to a greater or lesser extent, a deleterious influence on Public schools, do not flourish under the operation of the free school system.

The Origin of Compulsory Schooling

There remained one area of discretion for the customers of education; they still possessed the freedom to restrict their consumption. They could remove their children from school at an earlier age than in those areas where better quality teaching existed and send them to places of employment where on-the-job training and education was provided.

Again the economic theory of politics can predict the responses of the school suppliers in such circumstances. Especially since public money was distributed to the schools, and thereby to the incomes of teachers and administrators, in proportion to the numbers in attendance, we can easily "predict" the kind of agitation that would next have been undertaken. The income maximizing teachers, managers,

⁹Nineteenth Annual Report N.Y. Supt. Pub. Instruction 39 (1873).

and other officials, especially those of average or less than average ability, would have sponsored a campaign for an education that was compulsory by statute.

The historical evidence is, in fact, compatible with such "prediction." Serious agitation for compulsory attendance built up very soon after the success of the free school campaign of 1867. The pressure by the Teachers' Associations for compulsory laws, following the victory in 1867 of their free school campaign, was soon rewarded. The Compulsory Education Act was passed in 1874. The final link in the process of monopolizing had now been firmly secured in the education of all children. Compulsory payment and compulsory consumption had become mutually strengthening monopoly bonds and the pattern of schooling for the next century had been firmly set.

Prompted then, not so much by abstract welfare theorems as by motives of self-interest, it is likely that those engaged in the initiation of a common school system to *augment* a private one will soon give reasons why the former should *replace* or *supersede* the latter. The acceptance of particular instruments of public intervention therefore, need not spring from logical demonstrations of normatively ideal and logical arrangements. It can also spring from (and is much more likely to do so) the successful salesmanship of those already employed in government undertakings.

Current Relevance

We can now continue the analysis by applying it to the present setting of the modern proposals for the establishment of tax credits. The same proposition from the economics of politics outlined above can help us predict who the opponents will be. Because the proposals can be expected to promote more competition from private schools, and since, as we have seen, the case for tax credits is strongest where positive prices are charged to public school users, the monopoly gains to the public suppliers of education enjoyed for over a century will become seriously threatened.

Consider then the serious proposal for tax credits for primary and secondary schooling put forward in the Packwood-Moynihan proposals of 1978, proposals that eventually suffered a narrow defeat.¹⁰ The prediction of the economics of politics is supported by the record of the organizations that came out in strong opposition. Table 1 illustrates some of them.

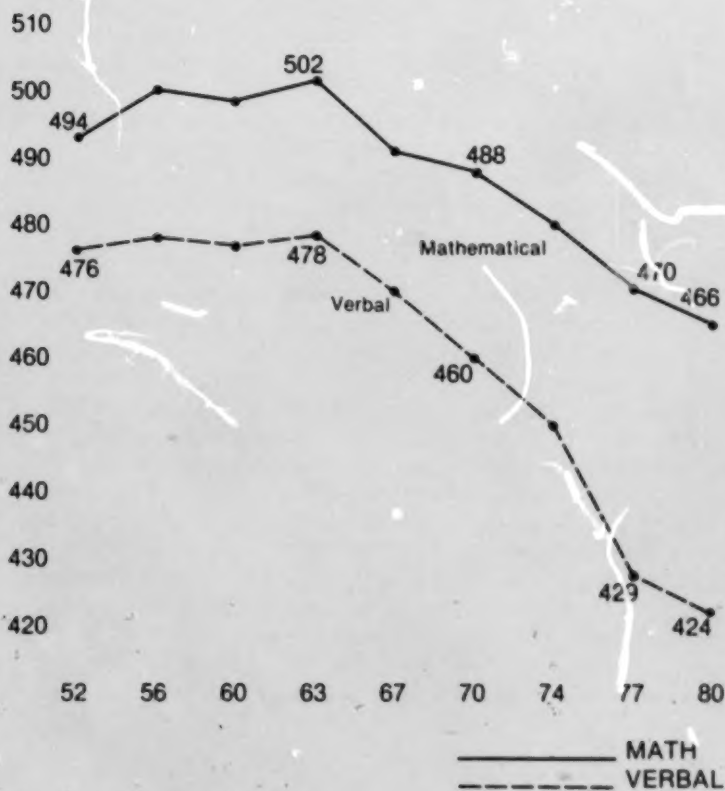
Since the theory predicts that monopoly and bureaucracy will increasingly control education and increase its costs, it can be tested by an appeal to the evidence. Some relevant recent facts are as follows: from the school year 1971 to 1972, the total professional staff in the U.S. public schools went up 8 percent while the money cost of education increased by 68 percent (or 21 percent allowing for inflation). But while inputs thus increased, "outputs" decreased. The number of students fell by 4 percent, as did the number of schools. As shown in Graph 1 the educational testing scores of all kinds (S.A.T., College Board Examinations and Short Common Tests) showed declining student performance. It will be seen from the graph that the downward trend in the S.A.T. scores has been continuing right down to the latest reported figures (for 1980). The average verbal score, which dropped two points to 427 in 1979, fell to 424 in 1980. Over the same period the average mathematical score, which dropped one point to 467 in 1979,

¹⁰For details of this scheme see E. G. West, "Tuition Tax Credit Proposals: An Economic Assessment of the 1978 Packwood/Moynihan Bill," *Policy Review* No. 3, Winter 1978. We shall make a detailed analysis of the P/M plan in Chapter 5 below.

Table 1
Organizations Officially Opposed to the 1978 Tax Credit Proposal

The American Association of Colleges for Teacher Education
 American Federation of Teachers, AFL-CIO
 The American Association of School Administrators
 The American Federation of State, County and Municipal Employees
 Council of Chief State School Offices
 Council of Great City Schools
 The National Association of Elementary School Principals
 The National Association of Secondary School Principals
 The National Association of State Boards of Education
 The National School Boards Association

Graph 1
SAT Scores, 1952 to 1980



fell by another point to 466 in 1980, despite the fact that students took more math courses than ever before. A perfect score on each test is 800.

In 1977, a special panel established by the College Board to investigate the causes of the downward trend, reported that, among other things, lower teaching standards were a significant factor.

Some evidence is available, meanwhile, that might well be relevant to the question whether increased bureaucracy causes the increases in education costs reported above. For the years where data are available (1968-69 to 1973-74), while the student population increased 1 percent and teachers 15 percent, the increase in supervisors was 44 percent.

The strong tendency to centralization is shown in the 17 percent decline in the number of school districts between 1971 and 1978, a development that is known as "consolidation." Administrators usually urge consolidation on the grounds that important economies of scale can be gained. Yet several studies report that such economies are not reached beyond a relatively small size. One of the important costs of consolidation, meanwhile, is that parents as voters are less able to articulate their preferences and have them respected because both "voice" and "exit" (to neighboring school districts) are considerably weakened.

There is in addition some evidence that private schools, on average, are able to provide education equal or superior to that provided by the public schools but at a lower cost. One recent study shows that in the late 1970s in Manhattan the annual per pupil cost was \$2,647 in public schools but only \$462 in Catholic schools.¹¹ Other evidence on this subject will be discussed systematically in Chapter 4 below.

The prediction, from the economics of politics, that organized union spokesmen will encourage their own view of the history of schooling, is supported by declarations made by Mr. Gus Tylor, assistant president of the ILGWU in 1979. Because of the "threat" of vouchers for education, he warned, that "The American system of universal, free public school education, now about 150 years old in this country, is in deep danger."¹² At least one part of this statement is incorrect. As we have shown, New York, which was not untypical of other states, did not introduce "free" public school education until about 50 years after the schools were first established. The word "universal" in Tylor's remark, moreover, is erroneous, at least for the first 50 years of public school establishment.

Tylor also insisted that "one of the main purposes (of establishing

¹¹Robert G. Hoyt, "Learning a Lesson from the Catholic Schools," *New York Magazine*, September 12, 1977.

¹²Gus Tylor, "Playgrounds for Promotion and Prejudice," *New York Times*, October 7, 1979. Tylor was guest columnist for Albert Shanker, President of U.F.T.

Common Schools) was to create a common ground where children of different classes, religions, and ethnic communities could meet. The school was to be a sort of social cement."¹³ This belief seems to be widespread. James Coleman, for instance, similarly believes that "American public education was, from its beginning, a single system, founded on the ideology of a single 'common school' to which children of all economic levels and all groups would be sent."¹⁴ In fact huge numbers of immigrants in the 19th century went through *parochial* schools. Furthermore, the half-million "free persons of color" in the United States before the Civil War were, in most cases, not even permitted in the public schools or the private schools, often under penalty of law.¹⁵

We have seen, in any case, that there is no evidence that the "objective" of a homogeneous schooling was the spontaneous demand of the people. It was one that had to be sold to the public by special interest groups. Interestingly enough, the particular instance of it in the organized teachers' argument that we quoted above was a demand for the almost coercive inclusion into the public schools, not of the children of "people of color," but of the children of the *rich*. The implications for the public school teachers' own incomes are obvious.

The warning that the introduction of tax credits for education in the 1980s will undo the "social cement" that the public schools have supposedly accomplished is employed very frequently by opponents. It has recently been repeated, for instance, by Albert Shanker, the President of the United Federation of Teachers.¹⁶ Apparently championing an announcement by the IRS that it intended to "review" the tax exempt status of those private schools that do not have the required proportion of blacks, Shanker seems to assume that the public school system is without "blemish" in this regard.

But when examining the record of different school systems on social integration, the independent school should be evaluated against the social and income norm for the major users in each area. One question is, for instance, whether wealthier children in independent schools are more racially isolated than wealthier children in public schools. In the suburban areas of New York there is on average not more than 2 percent minority enrollments in public schools and the proportion of low income children attending is also tiny. Meanwhile the 44 private schools in New York City that are members of the National Associa-

¹³*Ibid.*

¹⁴James Coleman, et al., *Parents, Teachers and Children: The Prospects for Choice in American Education* (San Francisco: Institute for Contemporary Studies, 1977), p. 2.

¹⁵Thomas Sowell in Coleman, *op. cit.*, p. 166. Sowell adds, ironically, that more than half of this same population group was literate by 1850.

¹⁶Albert Shanker, "Problems for Tax Credit Seekers to Ponder," *New York Times*, September 31, 1979.

tion of Independent Schools were found, in a recent survey, to have a minority enrollment of twice the national average.¹⁷

Table 2 presents some information on the relative intake of minority groups into public and private schools. It shows that in California, the very place where important constitutional initiatives are under way in 1981 to establish vouchers and tax credits, the percentage of minorities in private schools, 22.1%, is not much different than that in public schools: 27.3%. Such figures challenge the widespread view, recently expressed by Senator Ernest F. Hollings, that it is wrong to relieve the financial pressure on independent schools because they are typically selective and simply serve those families who are fleeing from the inner-city, integrated school. "The public school, in contrast," Hollings argued, "must take all comers—regardless of background, regardless of special problem."¹⁸

Table 2
Minority group enrollment as a percent of total elementary and secondary enrollment in public and nonpublic schools, by region and State:
United States, 1970-71

Region and State	PERCENT MINORITY	
	In public schools*	In non-public schools
Total U.S.	20.9	10.1
NEW ENGLAND	8.8	3.8
Connecticut	12.2	8.9
Maine	.8	1.1
Massachusetts	8.0	2.9
New Hampshire	.8	1.4
Rhode Island	4.9	2.4
Vermont	.4	1.3
MIDEAST	22.0	9.8
Delaware	21.3	5.6
District of Columbia	96.5	43.9
Maryland	24.9	7.8
New Jersey	20.0	7.8
New York	25.3	12.2
Pennsylvania	12.6	5.7
GREAT LAKES	14.7	7.3
Illinois	22.0	12.0
Indiana	10.3	8.7
Michigan	15.1	8.3
Ohio	13.0	8.0
Wisconsin	8.0	2.2
PLAINS	7.3	4.3
Iowa	2.2	1.2

¹⁷Thomas Vitullo-Martin "New York City's Interest in Reform of Tax Treatment of School Expenses," *City Almanac* 13, No. 4 (December 1978).

¹⁸Ernest F. Hollings, "The Case against Tuition Tax Credits," *Phi Delta Kappan*, December 1978.

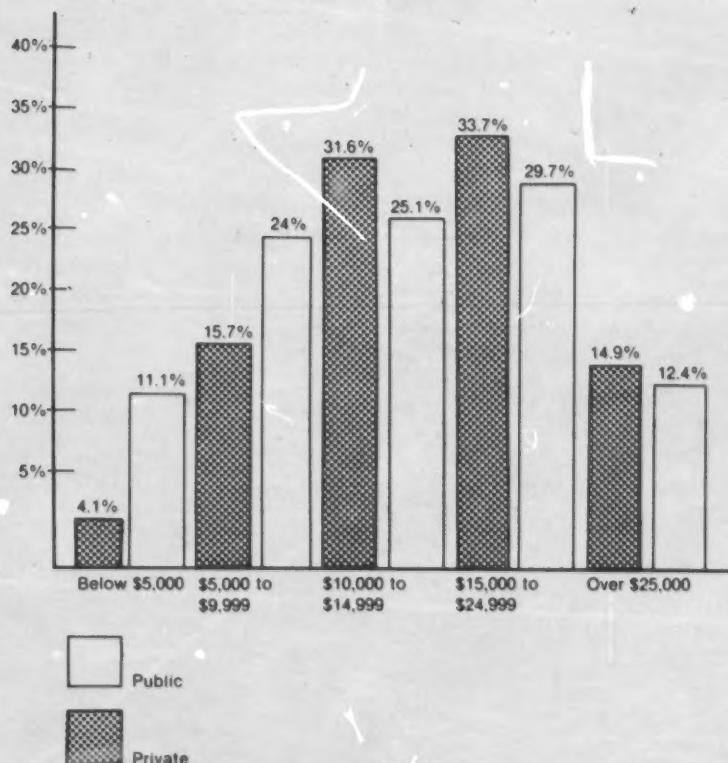
Table 2 (Continued)

Minority group enrollment as a percent of total elementary and secondary enrollment in public and nonpublic schools, by region and State:
United States, 1970-71

Region and State	PERCENT MINORITY	
	In public schools*	In non-public schools
Kansas	8.8	6.6
Minnesota	2.8	1.8
Missouri	15.1	7.3
Nebraska	7.0	3.4
North Dakota	2.0	2.1
South Dakota	5.7	19.6
SOUTHEAST	29.2	11.6
Alabama	34.3	17.7
Arkansas	20.1	13.8
Florida	27.9	17.3
Georgia	33.5	10.3
Kentucky	9.3	4.7
Louisiana	41.0	10.4
Mississippi	51.0	5.7
North Carolina	30.7	12.1
South Carolina	41.2	2.0
Tennessee	21.2	8.3
Virginia	24.7	6.2
West Virginia	4.9	2.8
SOUTHWEST	34.0	30.3
Arizona	28.8	25.5
New Mexico	48.1	66.7
Oklahoma	18.0	12.5
Texas	37.9	30.0
ROCKY MOUNTAINS	11.7	15.7
Colorado	18.8	19.2
Idaho	4.4	5.4
Montana	7.3	11.1
Utah	16.2	11.6
Wyoming	8.9	22.0
FAR WEST	22.8	20.5
Alaska	17.8	43.1
California	27.3	22.1
Hawaii	NA	51.3
Nevada	14.3	9.0
Oregon	4.5	3.7
Washington	7.0	5.8

*Sources: Department of Health, Education, and Welfare, Office of Civil Rights, Directory of Public Elementary and Secondary Schools in Selected Districts: Enrollment and Staff by Racial/Ethnic Group, Fall 1970. NCES, *Statistics of Nonpublic Elementary and Secondary Schools, 1970-71*. p. 16.

Chart 1: Income Distribution of Families of Students in Private Schools as Compared to Distribution of Family Income in the U.S., 1974



Source: U.S. Bureau of the Census, *Statistical Abstract of the U.S.: 1975*, Washington, D.C., 1975; and U.S. Bureau of the Census: *Current Population Report*, October 1974; "Social and Economic Characteristics of Students," as cited in *Outlook*, CAPE, April 1976, Washington, D.C.

Consider next Hollings's view that "most of our private school student population is middle or upper class." In fact, (as Chart 1 shows) the family incomes of private school students are more similar to the income distribution patterns for the whole U.S. population than is often believed. While it is true that a greater proportion of the public school population had an income of under \$10,000 in 1974 (35 percent versus 20 percent), in the next income group (\$10,000 to \$15,000) private schools find six percent more of their total population than do

public schools. Finally in the highest income groups (over \$25,000) private schools enrolled only 2.5 percent more wealthy students than did public schools.

More important, the public schools that cater for upper income families usually spend considerably more per pupil than do private schools taking in similar students. In the mid 1970s the highest-spending public school district in the New York Metropolitan area spent \$8,600 per student. This was more than any private school in the city and two and a half times the average expenditure of NAIS schools.¹⁹

The property taxes that generate revenue for such expensive public school systems are tax deductible. In effect this means that general taxpayers through the federal government are paying one half or more of the cost of such "free" public schooling for the rich. At the same time, such expensive suburban public schools present more barriers to low income groups than do urban private schools since they permit only children living within their boundaries.

¹⁹Testimony of Dr. Thomas Vitullo-Martin, Hearings of the Senate Finance Committee, Sub Committee on Taxation and Debt Management, January 18, 1978, on Tuition Tax Credit Bill, S. 2142.

Education Tax Credits: The Potential Gain for Taxpayers

The main purpose of this chapter is to examine the probable reasons why new proposals to help private choice in education such as the tax credit and the voucher systems are having a remarkable resurrection. Again, any positive analysis must start from the facts. They include the following: although proposals for tuition tax credits were narrowly defeated in the last Congress, they are again being considered at both the federal and state levels. Earlier campaigners for tuition tax credits such as Senator Daniel Patrick Moynihan are again active. Indeed, a new version of the earlier Moynihan-Packwood Tuition Tax Credits Bill has been reintroduced into Congress. More interesting still is the fact that the earlier advocates are now being supported by new and diverse political bodies. Proposition 13-type taxpayer groups are now demanding "educational tax credits," joining parents who are sensitive to what they see to be deficiencies of government-run schools.²⁰

Clearly, the traditional support for the public school system can last only as long as firm political backing persists. When that disappears or weakens the innovations of tax credits and vouchers will gain still further attention.

The objective social scientist will naturally search for hypotheses and explanations for the new trend of support for these new "reforms." The support is clearly linked with demands for less costly government. The fact that Proposition 13 followers, for instance, favor educational tax credits suggests their intuitive belief in the promise of financial economies. It will be helpful, therefore, to investigate the possibilities and extent of potential taxpayer gains following the adoption of practical tax credit schemes in the near future. The more tax saving potential there is, the more, presumably, will the political impetus for change be sharpened.

So far the strongest political influence in the determination of

²⁰Manuel S. Klausner, "Tuition Tax Credits: A Debate Revived," *Inform* (Center for independent Education), No. 10, September 1979.

schooling in America has been the organized supply interests of teachers and administrators. It does not follow, however, that such influence will *always* be so dominant. The mere fact of demographic change in America is leading to a shift in the voting payoffs for politicians. As the average age of the population increases, the day approaches when the median voter shifts from having, say, two school-age children, to one and eventually to none at all. He will, accordingly, be less and less enthusiastic about collectivized spending on education and will begin to display a preference for more direct provision by parents themselves. This situation could well come about by the gradual introduction and increase of user charges (fees) for education.

The current political trend towards a more favorable voter disposition to financial relief for private schools should not be underestimated. It is certainly not a passing aberration of the early 1980s. We should remember that the famous Supreme Court cases of the 1970s dealing with "aid to nonpublic schools" revealed a judicial rather than a political opposition. In the famous *Nyquist* case of 1973, for instance, the electorate had already decided its willingness to provide grants, vouchers, and tax credits to private schools and their users. But when we add to this obvious political upswelling, a voter demands the increasing concern over the inefficiencies of the public system, the political impetus seems destined to become cumulative.

U.S. Private Education in Statistical Perspective

America's system of private schools represents an important component of the nation's elementary and secondary education system. More than 18 percent of the elementary/secondary schools are under private control. In addition, private schools enroll more than 10 percent of the students, employ 11 percent of the teachers, and account for about 10 percent of the high school graduates. But although they generate at least 10 percent of the output of education in America they spend only about 6 percent of the total amount of current expenditure in the U.S. as a whole. The scale of operations of private schools tends to be smaller than that of public schools, since they have fewer enrollments. At the same time the private schools, generally, have lower teacher/pupil ratios than do public schools. One-half the total number of private schools are operated by Catholics and they enroll almost two-thirds of the total number of pupils while employing more than one-half of the total number of teachers.

Systematic efforts to gather statistical data from private schools that could be compared to public school data have only been made very recently. With the support and cooperation of the Council for American Private Education and the National Catholic Educational Association, the National Center for Education Statistics surveyed all

Table 3
Public and private school enrollments:
United States, school years 1976-77 through 1978-79
(Numbers in thousands)

School year	Total	Public		Private	
		Number	Percent	Number	Percent
1976-77	49,496	44,317	89.5	5,179	10.5
1977-78	48,826	43,731	89.6	5,095	10.4
1978-79	47,637	42,559	89.3	5,078	10.7

Table 4
Pupil/teacher ratios in public and private schools:
United States, school years 1976-77 through 1978-79

School Year	Total	Public	Private
1976-77	20.1	20.3	18.8
1977-78	19.8	19.9	18.5
1978-79	19.3	19.4	18.5

private schools known to exist during school years 1976-77, 1977-78, 1978-79 to acquire data on enrollments, staffing, and finances.²¹

One of the interesting facts is that during this period of declining enrollments, private schools have been "surviving" somewhat better than public schools. Public school enrollments decreased by 4 percent compared with 2 percent in private schools. This indicates a small relative shift of children from public to private schools, as will be seen from Table 3.

In this period of financial pressure, private schools were apparently able to economize on teaching staff more effectively than public schools. The number of teachers in public schools actually increased by 0.5 percent over the period despite the drop of enrollments of 4 percent. The number of private school teachers, in contrast, decreased by a greater proportion than their drop in enrollment: (0.4 percent compared with 0.2 percent).

Private schools enrolled just under 11 percent of the total number of pupils, but they employed just above 11 percent of the total number of teachers. This resulted in the slightly lower private school pupil/teacher ratio observed in Table 4.

Expenditures for current operations (see Table 5) increased by 10.2

²¹ National Center for Education Statistics Bulletin, U.S. Department of Health, Education and Welfare - Education Division, October 23, 1979, hereafter *NCES Bulletin*.

percent in total between school years 1976-77 and 1977-78. The increase was much larger in public schools (10.5 percent) than in the private schools (6 percent).

We come now to a set of figures that are probably the most relevant for any estimate of the potential gains to taxpayers from the introduction of a tax credit system. Table 6 shows that on average a private school accounts for just under 50 percent of current expenditure per pupil compared with an average public school. These figures need some qualifications. We shall postpone discussion of them, however, until later in the study. Meanwhile, it will be interesting to conduct some elementary calculations to explore the possibilities of tax savings using the figures as they stand.

It will be shown that a crucial factor is the propensity of families to switch into private schools when tax credits are available. We shall suppose, for the moment, that the "educational output" of the average private school is not very different from that of the average public school. Assume, in our first experiment, that the propensity to switch into private schools following tax credits will be zero. That is to say, the result of a tax credit provision will be to benefit the present users of private schools exclusively. Basing our estimate on the year 1977-78 this will mean a demand on the public revenues of an extra \$4.17 billion, the average tax credit per pupil being \$819 per annum. The net effect would be that since the users of private schools were no longer

Table 5
Expenditures for current operations of public and private schools:
United States, school years 1976-77 and 1977-78
(Numbers in \$ millions)

School year	Total	Public		Private	
		Amount	Percent	Amount	Percent
1976-77	66,983	63,046	94.1	3,937	5.9
1977-78	73,839	69,666	94.3	4,173	5.7

Table 6
Average current expenditure per pupil in public and private schools:
United States, school years 1976-77 and 1977-78

School year	Average	Public	Private
	\$	\$	\$
1976-77	1,353	1,544	760
1977-78	1,512	1,736	819

paying their normal net tax contributions, then others in society would have to pay more for given public goods such as defense, roads, etc., by increases in ordinary tax rates. Otherwise there would have to be some reduction in the output of such public goods (or a combination of both).

Suppose, in our second experiment, we find that after the tax credit is provided, 10 percent of the public school population transfers to private sector schools and that the private system can, in the long run, cope with such an increase at no extra average cost. From Table 6 we see that average expenditure per pupil in public schools in 1978 was \$917 larger than that in private schools. This means, in our present experiment, that for every student transferring to the private sector the government authorities would have saved, on average, \$917. When we compare this with the expenditure on the pupils already in the private sector, at a rate of \$819 per head, we see that there is a saving of \$98 per head when a number of students equal to the population of the private schools, transfers from the public schools. The total saving, in fact, would be over two-fifths of a billion dollars or \$425 million.

On this reasoning, therefore, the Proposition 13-type voters will welcome the tax credit scheme so long as they envisage at least 10 percent of the public school population transferring to private schools. Carrying this calculation a little further, we see that, beyond the 10 percent transfer, the taxpayer saves \$917 on every additional child who moves from a public to a private school. If we suppose that 20 percent, or one-fifth, of the public school population transfers to the private sector, there will, in fact, be a saving of nearly \$4 billion.

So far we have been assuming that the tax credit provides for the full amount of the average current expenditure per pupil in private schools. This need not be the case; and indeed the Moynihan-Packwood proposals amounted to \$500 per head, which is just over one-half of the magnitudes being considered here. Suppose, then, that government had offered a tax credit in 1978 equal to one-half the private school expenditure per head in that year, that is, one-half of \$819 or \$409.50. If there were zero pupil transfers from public to private schools, the cost to the authorities would have been just over \$2 billion. If there were positive transfers such that 5 percent of the public school population moved to private schools, there would have been a net gain of a quarter of a million dollars. Thus at tax credits worth \$409.50, Proposition 13 voters would be enthusiastic if they calculate that at least 5 percent of the public school population would move to private schools.

Clearly, the higher the value of the tax credit, the greater the proportion of the public school population that has to move into private schools before taxpayer gains are realized. The "moral" is that those who wish to design tax credit proposals, especially if they assume that

voters are risk-averse, will wish to bias their value downwards in the first few years of operation.

In the popular imagination, the new "liberation" of choice in education will probably be envisioned in the form of pupils moving exclusively into *existing* private schools. In our last example the break-even point for taxpayers would come when just under 5 percent of the public school population moved. But this would mean a crowding of 50 percent more students into currently built independent schools. If this would seem to be too close to reasonable tolerance levels, it would be more so with the movement of 10 percent of the public school population. And it is such a movement that is required for taxpayers to break even when the tax credit values reach the full extent of the private school expenditures. Such a move would, in fact, *double* the population in existing private schools.

But although average voters may not initially grasp the point, the fact is that when such numbers swell the demand for private education, entirely new independent schools are likely to appear. New "branch plant" schools, for instance, will be constructed within the church-affiliated section of private schooling. It is probably true, all the same, that the average taxpayer will need some kind of demonstration effect of this. Tax credit advocates, therefore, would seem to be well advised to exercise conservatism in the initial stages. On this reasoning the 1978 Moynihan/Packwood proposal of a \$500 tax credit would seem to have been particularly judicious.

Qualifications

We have yet, however, to return to the necessary qualifications concerning the differences of expenditures between public and private schools. The National Center for Education Statistics recommends caution in making comparisons. More than three quarters of the private school teachers are employed by church-affiliated schools. Services contributed by teachers in these schools result in lower salary expenditures than those found in non-affiliated and public schools. Teachers' salaries, of course, are an important part of the total operating costs and amount to between 60 to 80 percent of a school's total expenditure. Unpublished data indicate, for instance, that approximately 20 percent of Catholic school teachers are members of religious orders and are paid at substantially lower rates than other teachers.²²

Yet the relevance of these observations is not entirely clear. It does not necessarily follow that because teaching members of religious orders obtain lower salaries than other teachers they are further away from "true" market levels. Public school teachers are strongly unionized, so there maybe significant monopoly elements in their salaries

²²NCES Bulletin

that place them well above market levels. It would then be quite rational for consumer-citizen taxpayers to move to a system that purchases less monopolistically determined costs of their services.

If, on the other hand, the religious teachers are accepting salaries lower than market levels, we must presume a significant degree of charity donated by the teachers concerned. But notice that only 20 percent of the private teachers are reported to be in this category. Moreover, it is not necessarily irrational on the part of consumers of education to wish to give a greater proportion of children the advantages of such charitable behavior! Certainly there is a question whether the numbers in this teaching class will increase sufficiently when private school populations begin to grow following tax credits. But such questions cannot be answered until an opportunity has been given for a tax credit scheme to operate.

It would be extreme reasoning, to say the least, if it was suggested that disproportionately low teaching salaries make all the difference in the current expenditures between public and private schools. If this was so, the teachers in private schools would be receiving less than half of the salaries of those in public schools. This is clearly not true.

Some non-teaching sources of the relative efficiency of private schools may be deduced from Table 4. It shows that the increase in average current expenditure per pupil was greater in the public sector over the years 1977-78 compared with the private sector. Over this period the ratio of private to public expenditure went from 49.2 percent to 47.18 percent. Although there was some change in teacher employment between the two sectors it was far from sufficient to account for this relative increase in the efficiency of the private compared with the public sector.

Finally, the National Center for Education Statistics cautions that the figures for private education were collected on a school-by-school basis and about one half of the schools did not respond. Fifty percent is a large sample, nevertheless. And if it was biased at all it would have been because of the over-representation of larger and higher income schools (which can more readily afford the time and cost of answering surveys). This means that, if anything, the figures of expenditures per pupil reported in our Table 6 would be overestimated. This being so the cost differences between private and public schools would be even more striking.

Comparisons With Other Public Services

In the judgement of the present writer then, after appropriate caution has been taken in comparing private costs with public costs in education, the impression remains that the costs of private schooling are significantly lower. This conclusion will not come as a surprise to economists. For a half a century now they have been employing syste-

matic analysis to explore the differences in private wealth pursuits by public and private firms. More importantly, they have recently been obtaining strong empirical evidence of public/private cost differences that appear to match those just found in education. It has been discovered, in other words, that production efficiency constraints are far more effective in private than in public firms. Public firms produce output at higher cost, their managers enjoy "quieter" lives, and they have greater levels of discretion.

On the subject, for instance, of private contracting versus public supply of fire services, it has been found in the two U.S. localities studied, that the private firm turned out the same effective service for half the cost. Other research has estimated that there is a 40 percent savings of the private over public arrangements for garbage collection. Another economist has found that the private regulated firm in domestic air services in Australia enjoys a higher productivity for its inputs than does the Crown airline, though by law their routes and travel time are equal and equipment identical. In the areas of ship repair, weather forecasting services, and debt collection, a new study published in 1980 based on U.S. General Accounting Office material calculates that costs are at least double or triple in the public as opposed to the private sector. Strong evidence is also available showing that the operating costs of publicly owned water companies exceed those in private companies.²³

Yet another study demonstrates the upward bias in relative prices of the inputs used when the government becomes the actual *producer* of services. This has been illustrated with reference to the case of day-care. The study concluded that direct government provision of day-care services in the Canadian province of Ontario tends to raise costs significantly. Two reasons were offered. First there is less incentive to reduce costs than in the private sector because of the problem of "shirking" or bureaucratic inefficiency. Second, workers tend to demand, and receive, higher wages from large monopolistic public-sector employers than from many small private undertakings.²⁴

Viewed in the perspective of these studies, the figures examined here, of public school expenditures per head being twice those in private schools, are not particularly surprising. And even if some adjustment should be made for the "charitable" elements in some of the teaching salaries in church-related schools we should also remember that the assumption of our analysis has been that the educational "outputs" of the independent and public school systems are not very differ-

²³The full references to these studies are contained in Thomas E. Borcherting, "Towards a Positive Theory of Public Sector Supply Arrangements," Department of Economics and Commerce Discussion Paper 79-15, Simon Fraser University.

²⁴M. Krashinsky, *Daycare and Public Policy in Ontario* (Toronto: University of Toronto Press, 1977).

ent from each other. Insofar as families believe that the output of private schools are more efficient on average than that of public schools, there will be a further adjustment to be made that counters that for salaries just mentioned.

There is little published research on the differences of school outputs and clearly much more is needed. It would be particularly interesting to compare the number of *hours* of teaching especially in the area of literacy skills. Insofar as the average teaching profession in public schools is more union-organized than that in the private sector, it may well be that the total hours of educational "output" are somewhat less in the public sector. But even without concrete empirical research the question of political preference is influenced more by what individual voters and parents *believe* to be the differences in efficiencies of institutions of which they have knowledge in their locality.

The conclusion is, therefore, that the estimate of potential taxpayer gains made above is not too far from the truth. A tax credit based on one-half of the current average operating expenses per student in the private sector will begin to generate substantial gains after 5 percent of the public school population has transferred to private institutions. Taxpayers who do not have children will especially welcome this event. Those who do have school-age children will also enjoy their smaller obligations to the total tax bill, as well as the greater freedom of choice in their own childrens' schooling.

Origins of Tax Credits and Recent Federal Proposals

Tom Paine's Education Tax Credit System

The origin of the idea for tax credits to enable people to purchase education in private schools is to be found at the end of Tom Paine's *The Rights of Man*, published in 1792. Because we feel that the present age has much to learn from Paine, a brief account of his argument will be helpful here before proceeding to a review of recent U.S. federal tax credit proposals.

There seems no doubt that if Paine were living today he would probably be a leading figure in the Proposition-13-type movement. As is well known, that movement stems from the increasing resentment of continually growing taxation together with opposition to increasing deficits and overexpanded government. In Paine's world, too, taxes had been rising for some time, indeed for three centuries. In those days in England there was no income tax and most of the taxes were regressive, and fell especially severely on consumption items such as sugar, beer and tobacco. It is true that in the 1790s about 12 percent of all British government revenue came from the land tax paid largely by the aristocrat. It so happened however that this was the only tax which was falling.

Paine focused on the current expenses of government and argued that they could be reduced to less than a quarter. It was in his search for an appropriate way to dispose of the surplus that the proposal for educational tax credit emerged. While considerable reductions of the excise tax were part of Paine's plan, he insisted that there should be a nice discrimination within the group that paid it. The same was true with respect to this proposed reduction of the poor rates. (These taxes were largely escaped by the aristocrats.) Money taken in such taxation from average families was much more than enough, Paine argued, to finance the basic education of their children. A laboring man with a wife and two or three children paid a fourth of his yearly earnings in taxes even though "He is not sensible of this, because it is disguised to him in the articles which he buys, and he thinks only of their dearness."

In his final scheme to distribute the surplus revenues from unnecessary taxation Paine proposed to pay as a *remission of taxes*:

... to every poor family, out of the surplus taxes, and in room of poor rates four pounds a year for every child under fourteen years of age; enjoining the parents of such children to send them to school, to learn reading, writing and common arithmetic; the ministers of every parish, of every denomination to certify jointly to an office, for that purpose, that this duty is performed.²⁵

It should be noticed too that Paine was not suggesting compulsory schooling. His argument was that families would naturally purchase it if only they were not made so poor by the heavy taxation. Indeed the large section of the poor were already purchasing some education despite all obstacles. Paine's whole operation would, he thought, relieve the poverty of the parents: "because it is from the expense of bringing up children that their poverty arises." His scheme in fact can be seen in terms of a move from our Model 1 to Model 2 in Chapter 1 of this study.

Paine was also concerned with the difficulty of inaccessible schooling in sparsely populated area. To meet this problem, he proposed a special allowance for each child living in these areas. The allowance would amount to 10 shillings a year:

... for the expense of schooling for 6 years each, which would give them 6 months' schooling each year, and half a crown a year for paper and spelling books.²⁶

Paine also anticipated the problem of administrative feasibility and claimed that his plan was easy in practice; "It does not embarrass trade by a sudden interruption in the order of taxes, but effects the relief by changing the application of them; and the money necessary for the purpose can be drawn from the excise collections, which are made eight times a year in every market town in England."²⁷

Paine's scheme distinguished itself from the typical proposals of the classical economists of his time by directing the finance not at the school but at the scholar (via his parents or guardian). Adam Smith and several of his followers, in contrast, wanted to subsidize education but the subsidies were to be confined mainly to construction and maintenance of school buildings. Tuition fees were to be paid by all classes, however, and they were intended to contribute to the bulk of the teachers' salaries. Paine's proposal went much further than that of Smith, insuring the possibility of the exercise of the widest choice on behalf of a child. Under his scheme a bigger proportion of education

²⁵Tom Paine, *The Rights of Man*. Everyman's edition (London, 1961, p. 248).

²⁶*Ibid.* p. 252.

²⁷*Ibid.* p. 256.

expenditure would go through parental hands so that the competition between schools would be even greater.²⁸

U.S. Federal Tax Credit and Tax Deduction Schemes Until 1977

Schemes reminiscent of Tom Paine's have recently emerged in the United States. Several tax programs for education first began to appear during the 1950s. Mainly, however, these were bills to provide tax *deductions* rather than tax *credits* (the distinction is explained below).

Notice straight away that when proponents speak of deductions or credits today they usually have in mind deductions and credits relating to *income* tax. This is in a direct contrast with Tom Paine's proposals which were based on tax credits for *indirect* taxes paid, taxes such as excise duties. Of course, the income tax was not present in Paine's time. But even today it accounts for less than half of total tax revenues. Indirect taxes still provide more money to governments than does the income tax. And large taxes such as the corporate profits tax is passed on to consumers of all income groups.

Apart from the legal problems connected with tax *deduction* schemes, experience has shown that they confront considerable political opposition. This is because they favor the rich since they provide benefits that vary positively with income. Since the American income tax system is a graduated one, a benefit gives greater tax relief to a high-income taxpayer than to a low-income taxpayer. A \$100 deduction, for example, saves \$70 tax for the high bracket taxpayer whose marginal rate reaches 70 percent, whereas it saves only \$20 for the low-bracket taxpayer whose marginal rate climbs only to 20 percent. Those who pay no income tax obtain no benefit at all.²⁹

It was mainly because of such reasons that the tax deduction proposal lost ground in the 1960s to schemes for tax *credits*. These give an income-constant benefit because the credit of a given amount is subtracted directly from the taxpayer's bill, not from his income. High- and low-income taxpayers get the same size benefit as long as both have pre-credit liability equal to, or in excess of, the available credit. There is still a serious equity objection, however. The tax credit system fails to get assistance to low-income families who have little or no tax liability for the credit to offset. But as we shall see, some versions of the tax credit schemes adequately meet this objection.

Six education tax credit proposals passed the Senate between 1967 and 1977. Since most of them related to college education, and we are

²⁸For further details of Paine's proposal see E. G. West, "Tom Paine's Voucher Scheme for Education" *Southern Economic Journal*, January 1967, reprinted in E. G. West, *Education and Industrial Revolution*, Batsford, London 1975.

²⁹John K. McNulty, "Tax Policy and Tuition Credit Legislation: Federal Income Tax Allowances or Personal Costs of Higher Education," *California Law Review* 61 (1), January 1973.

interested mainly in primary and secondary schooling, we shall not discuss them in detail here. One feature emerged, however, that was later to be applied to tax credits for schooling. In 1971 Senator Abraham Ribicoff's (D-Conn.) tax benefits scheme for college tuition (initiated in 1967) reappeared with one interesting modification. It provided that the tax credit would be *refundable*. This means that a family would receive a cash refund to the extent that it owed no income taxes to which the credit could be applied.

The first significant tax deduction proposal for tuition appeared in 1975 and was introduced by Senator James Buckley (Cons. R-N.Y.). His scheme would have provided for a \$1,000 deduction for tuition payments to institutions of higher education, vocational schools, and elementary and secondary schools. Buckley's proposal was rejected, but it is widely believed to have been the forerunner of the famous Packwood-Moynihan bill presented in 1978.

The Packwood-Moynihan Proposal*

This proposal contained several meritworthy features. First, it was a tax *credit* plan which, as shown, has several advantages over the scheme of tax *deductions*. Further, the P/M plan incorporated the new idea of "tax refundability." This means, to repeat, that if the taxpayer is entitled to a credit greater than the amount of his tax liability, the difference is refunded to him in cash. The amount of the tax credit proposed was up to \$500. Thus in the case of an individual who has zero income tax liability he would have stood to qualify for tuition credit up to \$500 for a student.

There is a further point of equity concerning the P/M plan that has been overlooked in previous discussion. Most of the private schools in America have religious affiliations. As such they have been able to take advantage of the fact that contributions to them are deductible under the tax codes as they relate to charities in the broad sense of that term. Insofar as parents have been able to give "contributions" in lieu of tuition, they have already been receiving the *equivalent* of some tax credit. There is, indeed, some evidence that this has been happening.³⁰ Clearly this advantage has accrued to income tax payers exclusively. Furthermore, and within the income tax paying group it has benefited the higher income individuals progressively. The effect of the P/M legislation would have been to spread the advantage to the poor families that use private schools and which pay no income tax at all.

The second advantage of the P/M proposal was that it was not too

*Hereafter the P/M proposal.

³⁰R. D. Reischauer and R. W. Hartman, *Reforming School Finance* (Washington, D.C.: The Brookings Institution, 1973), p. 143.

ambitious. We argued in Chapter 4 that the higher the value of the tax credit, the greater the proportion of the public school population that has to move into private schools before taxpayer gains are realized. "Modest" credits therefore have a greater initial chance than those that extend to the full cost of the private tuition. This is especially so where taxpayers are looking for quick gains from the innovation and where the voters are risk-averse. The P/M proposal of credits up to \$500 would seem to suggest that about half the average private school expenditure was being covered. On our previous argument this implies that only five percent of the public school populations have to move to private schools to generate net taxpayer gains.

The Packwood-Moynihan bill also provided for tax credits for college users. Normally this would be difficult to justify on equity grounds. This is because most college users can expect to enjoy above average incomes over their lifetime whether they go to college or not. To give them special financial privileges would seem to give clear benefits to the middle and upper classes. There are two arguments however that qualify this charge.

First, insofar as government allows tax credits for physical capital (e.g. depreciation allowances), there is an argument on allocative if not on equity grounds that human capital (investment in post-secondary education) should be similarly treated. The second aspect of the post-secondary tax credit concerns possible changes in the whole structure of educational finance that the P/M proposal might have brought. The present structure relies, to a significant degree, on student loans and the tax credit proposal comes at a time when this system in America is at its lowest reputation in terms of efficiency. To the extent that the tax credit system begins to supersede the conventional loan system it could be an important source of cost saving for future years.

The public loan system seems to have failed, first because the banks have very little incentive to collect payments on loans once they are defaulted since the federal government provides a substantial guarantee. Second, the incentive to default is quite high and some students even declare bankruptcy in order to avoid repaying. There is certainly a logical case for a loan system. When it was first proposed in the early 1960s, however, it was intended that the system would use the already substantial machinery of the income tax authorities to collect interest on repayment. The incentive of individuals to default against income tax is likely to be considerably smaller than present incentives. (Bankruptcy, for instance, cannot be pleaded as an excuse for nonpayment of income tax.)

What was interesting about the P/M proposal was that it could be pleaded as a return to the philosophy of the loan system as originally intended and described—a system that uses the income tax machinery

for collections. It is true that Packwood and Moynihan did not present their plan in such a light, and they spoke of the facility as providing state *aid*. Nevertheless, the burden of their argument was that unless their proposal was adopted, many students would not receive higher education, and ultimately the government would receive less in tax revenues. Conversely, if the tax credits were successful, users of the P/M system would eventually "pay back" the income tax authorities a higher volume of tax revenues than they otherwise would. In this sense the P/M tax credit plan can be regarded as a device that *stimulates* a loan system and moves in the direction of efficiency in lending in contrast to the present conventional loan system.

One disadvantage with the P/M plan was that the credit was limited to 50 percent of a school's tuition charge. This involves a discrimination against the users of the less expensive private school. Thus a person attending a school whose fees amounted to \$500 would receive only \$250 in tax credit whereas families using schools charging \$1,000 would receive \$500. The P/M plan would have been better without this condition.

The 1979 Tuition Tax Credit Bill: S. 1095

Following the defeat of the P/M scheme, Bill S. 1095 offered in 1979 tax credits of \$250 per elementary and secondary student and \$500 per post-secondary student for fees paid for tuition. As in the P/M bill the credits apply to each member of the immediate household—head, spouse, and dependents. Similarly elementary and secondary schools are defined as in the elementary and secondary educational act of 1965; in addition, eligible educational institutions must be privately operated and in accordance with state law and be exempt from taxation.

This bill contains the same disadvantage as the P/M plan in that the tax credit allowed per child cannot exceed 50 percent of tuition paid. But it suffers a much more serious disadvantage than the P/M scheme since the tax credit is not "refundable." In this case, unlike the P/M version, if a family has no federal income tax liability, it receives no aid. This means that in order to enjoy tax credits families must have a taxable income of \$7,000 or more. This is clearly a discrimination against many poor families and especially single head households where the mother has to take a job at low rates of pay to support her children.

It will be seen then that this latest attempt to establish the tax credit is far removed from the intention and philosophy of Tom Paine who wanted to discriminate in favor of the education of the poorest. And Tom Paine reminds us that everybody pays taxes whether he contributes to income tax or not. The poor pay sales taxes, property taxes and

taxes on all kinds of goods and services. There is no logical reason why a tax credit scheme could not respectably argue that credits were being made available also for such indirect taxation. Bill S.1095 seems most conspicuous in its neglect of this simple point.

State Proposals

The 1980 California Educational Tax Credit Initiative

The California initiative, which was circulated for the 1980 ballot, was sponsored by the National Taxpayers Union. Although it was subsequently withdrawn, it contained interesting features worth discussing here, especially because most of them have reappeared in the Washington, D.C., initiative for the November 1981 election.

The Central Features

According to the summary prepared by the Attorney General of California, the chief purpose and points of the proposed measure were: First to provide a state income tax credit for taxpayers who paid educational expenses on behalf of California residents attending full time public or private schools providing instruction at the kindergarten stage through high school levels. The credit was also to be available for those attending institutions of higher learning where admission is conditioned upon a high school degree or equivalent. The credit was limited to \$1,200 per student for tax years ending on or before December 31, 1981, with provisions for annual increases after that. The state was prohibited from imposing on private educational institutions more restricted requirements in the Compulsory Education Law than those in effect June 1, 1979.

Following our discussion in Chapter 4 it would seem at first sight that the conspicuous feature of the California scheme was the relatively high level of the tax credit limit. Judging from the published figures of an average current expenditure in American private schools, \$1,200 would seem to be more than ample.

Table 7 shows the U.S. average current expenditure per pupil in public and private schools as reported in the NCES Bulletin of October 23, 1979. The Bulletin's figures are contained in the first two rows. The third row is our own estimated projection for 1980-81. The projection is based on the assumption that the public school expenditure expands at its annual rate of 11.75 percent (the rate of expansion between 76-77). We assume that the private school expenditure will ex-

Table 7
Average current expenditure per pupil in public and private schools:
U.S. school years 1976-77 and 1977-78 extrapolated
to 1980-81

School Year	Public	Private
1976-77	\$1,544	\$ 760
1977-78	1,736	819
1980-81	2,423	1,090

Source: National Center for Education Statistics Bulletin, October 23, 1979.

pand at a lower rate and here assume that this is 10 percent. On this reckoning average per pupil expenditure in U.S. private schools in 1980-81 will be \$1,090. This falls well short of the \$1,200 limit contained in the educational tax credit scheme.

If we assume private school enrollments remained pretty much the same as in 1978-79, that is at nearly half a million, the California tax credit scheme would have benefited the existing private school population in 1980-81 by something over \$5 billion. This would have been the cost of the scheme if no transfers were made from the public to the private sector *and if each private user obtained the full benefit of \$1,200*. Insofar as transfers would have taken place there would have been a saving, since private schooling costs less. But it would have taken well over five million students to transfer before net gains to taxpayers emerged. And such a transfer would have caused the private school population to have increased by over 100 percent.

Clearly this magnitude of transfer seems to be a particularly large, at least in the short-run. On all these assumptions savings to taxpayers would appear only after several years of experience with the system, if at all. These findings seem all the more striking when we bear in mind that one of the main motivations of the National Taxpayers Union is to curb rising bureaucratic expenditures and therefore to reduce taxes. As the Chairman of the National Taxpayers Union has expressed its thinking in his preamble to the initiative:

The educational tax credit initiative... gives you a chance to cut off the bureaucrats who have been milking your wallet... [W]ith skyrocketing costs, growing violence, and "combat pay" bonuses now being handled out by some school districts, it is time to let families have a choice among schools.

Since therefore there appears to have been a considerable amount of Proposition-13-type philosophy behind the National Taxpayers Union initiative, it would seem, on our previous reasoning and all its assumptions, that the tax credit limit be well below \$1,200. A more suitable

and realistic figure would probably have been somewhere between \$600 and \$700. This level of credit would have generated much quicker gains to taxpayers (see Chapter 4 above).

Some important qualifications to our reasoning are now necessary. First, we have based our estimates on the figures for school expenditures across America as a whole. It turns out, however, that this qualification is not serious because the figure for public school expenditure per student in California is not far from the national average. Thus while the latter was \$1,736 in 1977-78, the equivalent for California was \$1,615 (across all districts).³¹ There are no separate figures for private school expenditures in California but it seems reasonable to assume that these also are not far from the national average.

A second qualification relates to the extent of inflation. We have assumed an annual increase of the public school cost of 11.75 percent and a 10 percent increase for private school costs. These figures were suggested from the general trend of increases over the last few years down to 1978. Since that year however the rate of increase of general prices and costs has gone up so that our estimates of average current expenditures per pupil for 1980-81 are likely to be on the low side. This means that the \$1,200 tax credit would not have been quite as "excessive" as we argued above.³²

Third, and more important, we have assumed that all private users would receive the full benefit of \$1,200 tax credit. This is not likely in practice. The \$1,200 figure is an upper limit and many will not reach it. The average benefit therefore would be much smaller.

Our fourth qualification is more complex. Even to the family that succeeded in obtaining \$1,200 worth of state tax credit, its net value would be less because of the interdependence between state and federal tax. State income tax is deducted from "gross" federal tax. If less state income tax is payable because of a tuition tax credit, more federal is incurred. Consider a family of four with a family income of \$50,000. Typically in California it would pay about \$3,000 maximum in state income tax. Assuming it pays this amount, it would earn \$2,400 tax credit for its two children. If the family's marginal federal tax rate was 50 percent (which is not unlikely) the net value of the \$2,400 worth of tax credit would be reduced to \$1,200, or \$600 per child.

In Chapter 4 we argued that, because private schools cost less, taxpayers *nationally* would enjoy significant overall tax reductions following the establishment of "modest" tuition tax credits of \$500-600, provided that about 5 percent of the public school population transferred to private institutions. If, however, one state establishes tax credits unilaterally, the taxpayer benefits will be spread disproportion-

³¹California Public Schools: *Selected Statistics 1977-78*, Sacramento, 1979.

³²Even if it was excessive now, inflation would soon erode its value.

ally in a geographic sense. In our last example, taxpayers outside of California would benefit from our family's increased federal tax burden. If other such Californian families pay more federal taxes, out-of-state families would pay less, provided the federal government keeps its expenditure budget constant.

Other Features of the Plan

Apparently one of the most awkward features of the California tax credit scheme was the fact that families who did not pay \$1,200 in state income taxes would not have qualified directly for the tax credit. The authors insisted nevertheless that tax credits could have reached such families through several alternative avenues. Relatives, churches, and corporations could all have used the proposed education tax credits. This means that a vast reservoir of assistance would have been available to capable and needy students. But this also would have meant that such families would have in some way to have been in a "suppliant" position *vis-à-vis* third parties in order to get their financial assistance for education. When we compare this with Tom Paine's system we see immediately the reason for this impediment. Paine's system, to repeat, provided credits for indirect as well as direct taxes. The California initiative, in contrast, concentrated on credit for income taxes, yet there seems no special logic in confining the credit to this one tax source.

Another intriguing feature in the argument of the National Taxpayers Union was that their tax credit would also have been spendable in public schools. This is because in the post-Proposition-13 era numerous public schools are now charging fees for sports, laboratory use, field trips, and other activities. These would become deductible. The tax credit would therefore have been of direct use in public schools too.

To some extent this feature goes against the scheme's claim that all taxpayers would save. If parents with children at school are thus relieved of their user fees, additional costs will be imposed on taxpayers who do not have children. At the same time it is arguable that this is a necessary cost to insure legal recognition of the plan. In the past, Courts have disallowed tax credits for private tuition alone, but have accepted as constitutional educational tax credits, like this one, that applied to *either* public or non public schools. But a tax credit can only apply to a public school if that school is charging fees of some sort.

The new tendency to charge user fees in public schools is an interesting one. Indeed it raises the question whether the post-Proposition-13 era might not lead to a demand that public schools charge some positive tuition fees as well as fees for the similar services just men-

tioned. But insofar as user fees do come back into public education (public schools have not already been free) competition will immediately return to the whole field of schooling.

It is a nice point of debate whether it will be better to wait for this development to achieve the same objectives that the tax credit advocates are espousing. These objectives are: economies in the running of public school and wider family choice. These same goals will be achieved the moment significant fees return to education. The advantage of relying on direct tuition, of course, is that there will be less administrative cost. Another advantage is that there are no constitutional obstacles to this method. When people pay their own money directly from their own pockets there can be no issue of "state aid," and no possible violation of the First Amendment.

It may be argued that to rely on fees is to make education more difficult for poorer families. But this depends on the nature of the fee and the taxes they are replacing. We have already offered the reminder that even the poorest families today pay indirect taxes that contribute to "free" education.

With every year that passes, and with current rates of inflation, such low income families are annually made to pay extra tax contributions. If the same increased contributions could be channelled through fees payable at the school such families would not be worse off. Indeed they would be better off because by paying their taxes in the form of direct user charges (fees) they will stimulate competition. This in turn will keep down costs so that the system will afford them a new protection and increased real income. And in the last resort, it is always possible to arrange special scholarships for the poorest of families.

One final aspect of the California tax credit scheme remains to be pointed out. It relates to the constant fear among the supporters of private schools that any tax credit scheme, like any voucher scheme, always contains the danger that the educational establishment will impose progressively stricter regulations on qualifying schools. The result could mean the erosion of all real independence of existing private schools. The California tax credit scheme however anticipated this very problem. It specifically prohibited the state from further restrictions in nonpublic schools. It offered guarantees that if a school would enroll pupils under *present* law, then taxpayers would use it to "spend" their tax credits.

The Washington, D.C., Tax Credit Proposal (1981)

In Washington, D.C., a Committee for Improved Education has been formed to introduce an initiative for tuition tax credits for the

November 1981 election. In the following details of this bill the reader will recognize strong similarities with the attempted California initiative of 1980.

The Central Features

The proposed D.C. educational initiative provides a \$1,200 maximum credit per student, to be used against D.C. income taxes. The students benefited may be enrolled in elementary, secondary, or post-secondary schools.³³ The unique feature of the bill, like that of its Californian counterpart, is that the credit can be taken by any taxpayer. This means that a grandparent or a corporation could sponsor a student and have his tax reduced by the amount of educational expenses incurred up to the maximum of \$1,200. Individual taxpayers may consume up to their entire D.C. income tax liability with educational tax credits. Corporations may also support the education of as many students as they wish under the tax credit's provisions (subject to the \$1,200 ceiling each), but may consume only up to 50 percent of their D.C. corporate tax liability with such credits.

The maximum dollar amount of \$1,200 is to be increased by ten percent of the previous year's maximum for each taxable year. This provision is qualified by the condition that the Council of the District of Columbia may each year specify a smaller or larger percentage increase upon the finding by two-thirds of all members elected to the Council of the District of Columbia that such percentage increase is equal to the rate of inflation for the preceding calendar year.

The D.C. government will be required to refrain from impairing the even-handed application of the education tax credit by further restricting existing educational alternatives via accreditation or other public school "protective" legislation.

The amount of available funds is expected to far exceed the number of children who will be in a position to use them.

Comparisons with the California Scheme

Since we outlined some problems with the California scheme, it will be necessary to inquire here whether, and in what degree, the same problems are associated with the D.C. variant.

The first potential problem has to do with the size of the tax credit. Throughout this work we have argued that logically any voucher or tax credit scheme designed to promote more competition in the educational system should be based on the costs of the least expensive cur-

³³Since the present study has been concerned exclusively with education up to and including the secondary level no analysis will be presented here of the effects on the post-secondary sector.

Table 8
Total Current Expenditure per Pupil in
Public Elementary and Secondary Schools
1977-1978

California	\$1,864
District of Columbia	2,706
United States	1,823

Source: U.S. Dept. H.E.W. National Center for Education Statistics, Revenues and Expenditures for Public Elementary and Secondary Education, 1977-78.

rent institution. We found that private schools, in fact, deliver education at a significantly lower cost. For this reason any tax credit or voucher should be based on a target that is closer to the private school cost per pupil. The question arose with the California proposal for a \$1,200 tax credit since the California average private school cost was well below that figure. We found that there were some reasons in California that could, to some extent, counteract this charge. The most important was the probability that most people would obtain less than the maximum tax credit in practice.

In the case of the District of Columbia, a figure of \$1,200 has more to be said for it because the costs of private education are likely to be much higher than the national average. This seems to be a reasonable conclusion to draw from the information in Table 8. It will be seen that the schools in the public sector had a total current expenditure per pupil in 1977-78 of \$2,706. By 1981 this figure will undoubtedly be around \$3,000. Since we argued earlier that private schools typically appear to be up to 50 percent less expensive than public schools, it is likely that the average private education in D.C. costs somewhere above \$1,200 for the tax credit.

The two remaining potential problems are: first, the question whether the scheme will cause inequality; second, the problem of the independence between state and federal income taxes.

The potential for inequality arises from the fact that the tax credits are based on income tax paid. Since many families do not pay it they will not be able to draw any benefit directly. As well, those families with higher creditable tax contributions will be able to enjoy benefits higher than those families with lower creditable contributions. We have pointed out the disadvantage with income tax credit schemes on *indirect* taxes paid—such as excise duties, tariffs, etc. We have also pointed out that the Packwood-Moynihan proposal overcame this disadvantage by incorporating the idea of "tax refundability" which provided a family with cash corresponding to the difference between the credit and its tax liability.

The D.C. proposal attempts its own answers to this kind of qu

tion. It emphasizes that families who do not pay income tax (or pay only a small amount of such tax) will be afforded assistance by third parties who earn the full credit. Relatives, for instance, will be able to earn tax credits for aiding a nephew, niece or grandson, etc. who requires such assistance. Other taxpayers who have no children, together with corporations, will be able to donate their credits to an organized charity such as a United Way or to some other voluntary social welfare organization. The organization can then distribute the money among the requisite number of students, either directly or indirectly. A taxpayer could also give to a school and the school could distribute the money in the form of scholarships either directly or indirectly to the students.

Since the United Way-type organizations are already well established they will be capable of accommodating the informational tasks of distributing educational tax credits-inspired gifts in accordance with the twelve hundred dollars per student ceiling. The proponents of the D.C. tax credit scheme believe indeed that the channeling of funds through organized voluntary social welfare organizations will account for the most giving under the credit system. Strong possibilities also include local community and or parent-teacher organizations and unions.

It may be objected that the practice of corporations granting the benefit of their tax credits will turn out to be pro-rich or middle class. This would occur for instance if the tax credits were directed exclusively at fringe benefit programs for the corporation's executives. There is no foundation in this objection. Firms able to donate tax credits will use them in competition with other firms when hiring labor of all grades. One firm in isolation may initially appear to have a special bargaining advantage over its competitors, and indeed it may attempt to profit from the arrangement by giving tax credits to their employees in lieu of a part of their wages. Such advantage would be temporary at most. Provided firms are in competition with each other, workers will obtain an increasing value of the tax credit as firms make their rival bids for employees. With full competition, workers should eventually enjoy the full value of the tax credit as a fringe benefit and without serious injury to their normal pay.

With respect to the problem of interdependency between the state and federal income tax, this would appear to remain a significant issue. Even if all families with children stood to obtain the full twelve hundred dollar benefit of the tax credit, the fact remains that individual taxpayers will have to pay more federal tax to the extent that they use their state tax credit. It would seem that there would be room here for negotiation between the state and federal government in search of a compromise or agreement. One arrangement would be for the federal government to treat the tuition tax credit as equivalent to state income

tax, in which case the difficulty would be removed. If this is for some reason difficult to accomplish there is another logical place on which to focus attention. We refer to the new bill being prepared for this session of Congress by the coalition that fought for previous Moynihan-Packwood tuition tax credit bill of two years ago. Ways could be found of complementing such federal tuition tax credit with schemes adopted in states such as D.C. It will certainly be interesting to see whether some sort of convergence between the D.C. scheme and that of the Moynihan-Packwood coalition will actually occur in the next few months.

Consider, finally, the possible motives for the National Taxpayers Union in transferring its endeavours from California to the District of Columbia. One probable reason is the smaller expense required in gathering signatures in the area of D.C., which is so much smaller than California.

Another likely reason, and probably the most prominent, is the symbolic nature of a successful outcome for the D.C. scheme. The District of Columbia is, after all, the focus of the federal government, so a clear and resounding object lesson would be there for all to see. The state movement could indeed strengthen and encourage its partner at the federal level. Also, if the federal and state governments could reach some arrangement that avoids the problem of the interdependence between the state and federal income tax, then all would be set for many other states to follow suit and copy the D.C. scheme.

Tax Credits Versus Vouchers

A final possible reason for the change in strategy of the National Taxpayers Union concerns the current initiative in California to establish a voucher scheme. To many who wish to see the principle of family choice adopted, the existence of two competing schemes in one state would appear to have the misfortune of "splitting the vote." Now that the California tax credit has been dropped, the way seems clear for the voucher system to obtain the requisite number of supporters.

It will be a particularly instructive experience if the voucher system succeeds in California at the same time that the tax credit system wins in D.C. The reason is that each system has its own special advantages and disadvantages and it would be very helpful to obtain real evidence on the workings of both.

Our own view is that the D.C. tax credit system has much more to be said for it than the voucher of the Californian type. The latter (under the leadership of Professors Coons and Sugarman¹⁴) is ham-

¹⁴For further details see E. G. West, "Choice or Monopoly Education," *Policy Review*, No. 15, Winter 1981.

pered because of the incorporation of special restrictions aimed at preventing segregation. Such restrictions invite the expansion of the public bureaucracy rather than its contraction. California schools that become very popular through the Coons/Sugarman voucher scheme will resolve their "congestion problem" by means of lotteries organized by yet another public agency. And it is the *legislature*, not the market, that is given the responsibility for encouraging diversity and experiment. The legislature is also to provide "a thorough system of information" concerning the available public and private schools.

The most severe restriction in the Coons/Sugarman voucher scheme is that against "add ons." These are allowed under the Friedman version of the voucher system. According to Coons and Sugarman, families unable (through low incomes) to add extra dollars would, with the Friedman-type voucher, patronize those schools that charged no tuition above the voucher, while the wealthier would be free to distribute themselves among the expensive schools. Friedman has replied that "vouchers would improve the quality of schooling available to the rich hardly at all; to the middle class, moderately; to the lower class, enormously."¹⁵ Friedman's argument is that the poor already get the worst deal of all *under the present public system*. It is this system, after all, which provides inferior schools in central city ghetto districts where it is impossible for many poor to escape.

On the question of segregation, one of the interesting features of the D.C. tax credit scheme is that it is planned for an area that is already populated predominantly by national minorities. Indeed, in 1971 about 44 percent of the population of private schools in the District of Columbia consisted of minorities, while the public schools had 95 percent minority representation! Clearly if tax credits become a reality in D.C. the predominant users of them will probably be the minority families.

On the whole it can be argued that the Coons/Sugarman voucher scheme is inspired by the value judgement of equality. That of the D.C. scheme in contrast is motivated mainly by the search for liberty. But it is strongly arguable that the liberty sought for will also bring more equality. The ultimate competition between schools will benefit all school users, those who use tax credits and those who do not. The latter will often be in ghetto schools that will at last face the threat of migration of their population to better institutions just outside. They will therefore be prompted to act more immediately and effectively in improving their quality and to pay greater attention to the preferences of families. And it is likely to be these poor families who will benefit most.

¹⁵Milton & Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, 1980), p. 169.

One final objection to the Coons/Sugarman voucher is that it conflicts with the requirements, stressed throughout our study, that the value of a voucher or tax credit should be based on the least costly (most efficient) institution. Since private schools typically supply education at almost half the cost of public schools, the value of the voucher or tax credit should be about 50 percent of public school costs. Coons and Sugarman however stipulate that their voucher is to be valued at 90 percent of public school costs. This provision therefore builds in and perpetuates the wasteful levels of spending that the new competition is supposed to remove. A Coons/Sugarman voucher in D.C. would reach the value of \$2700, which is more than twice the level of the D.C. tax credit proposed by the National Taxpayers Union.

Conclusion

There have been several serious endeavors to secure tax credits at the federal and state level in the U.S. in recent years. If anything the pressure for new attempts is increasing. The movement is obviously a citizen response to the increasing inefficiency of public schools. The latter is manifested in falling student achievement scores, rising public school costs, and increasing bureaucratization of the whole system.

One of the most interesting recent attempts to establish tax credits has occurred in the State of California where Proposition 13 measures are already afoot. Ordinary citizens there have been looking for reductions in all their taxes and appear to have been seeking ways of ensuring more efficiency in government services all round. The tax credit could well be an instrument to this end since it would increase competition of the existing private school system, a system that already enrolls 5 million students in the U.S. and nearly half a million in California. (The efforts to obtain a California tax credit have, however, now been transferred to the District of Columbia.)

Since there is evidence that on average private schooling costs about half as much as public schooling, any tax credit system that leads to a switching from private to public schools will, after a time, afford considerable tax relief for citizens who do not have children at school. But it has been shown also that the modern voucher and tax credit schemes are based on the assumption that public schools now charge fees of some sort or another. It seems increasingly recognized by all, therefore, that "free" education is coming to an end. Contrary to official opinion within the public school Establishment, such a return of positive-priced education can be beneficial, and (for reasons discussed) may be *most* beneficial, to families in the lowest income groups in the long run. There is no doubt that a tax credit scheme of the proper kind (and the National Taxpayers Union current plan for D.C. contains imaginative features) can assist the new trend and accordingly encourage much needed competition throughout the whole school system. And insofar as competition brings down the costs of education, as it should, taxpayers of all kinds, with or without children, will stand to benefit. Tom Paine's wishes of nearly two centuries ago may indeed yet be realized!

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Appendix

The Washington, D.C., Tax Credit Proposal

Short Title

*"Greater Educational Opportunities Through
Tax Incentives Law of the District of Columbia"*

Initiative Measure No. 000

By the Electors of the District of Columbia

To foster greater educational opportunities for students and scholars and thereby enhance personal liberties by providing a tax credit for educational expenses incurred or actually paid by District of Columbia taxpayers and for other purposes.

BE IT ENACTED BY THE ELECTORS OF THE DISTRICT OF COLUMBIA, That this measure may be cited as the "Greater Educational Opportunities Through Tax Incentives Law of the District of Columbia."

Sec. 2 The District of Columbia Income and Franchise Act of 1947, approved July 16, 1947 (61 Stat. 331, D. C. Code Sec. 47-1551 *et seq.*) is amended by adding a new title VIII A, to read as follows:

Title VIII A Educational Tax Credit

Sec. 1. (a) *General Rule.* — For the purpose of providing better and expanded educational opportunities for students and scholars, there shall be allowed to every taxpayer credit against the tax imposed by this Act for the taxable year an amount equal to the qualified educational expenses incurred or actually paid during the applicable taxable year.

(b) *Maximum Credit per Student or Scholar.* — For taxable years ending on or before December 31, 1982, the maximum dollar amount allowable to the taxpayer as a tax credit for qualified educational expenses incurred or actually paid shall not exceed \$1,200 for each eli-

gible student or scholar. This maximum dollar amount shall be increased by ten per cent of the previous year's maximum for each taxable year; provided, however, that the Council of the District of Columbia may each year specify a smaller or larger percentage increase upon a finding by two-thirds of all members elected to the Council of the District of Columbia that such percentage increase is equal to the rate of inflation for the preceding calendar year.

(c) *Maximum Credit per Individual Taxpayer.* — In the case of an individual taxpayer, the maximum dollar amount allowable as tax credits for qualified educational expenses incurred shall not exceed the amount of income tax payable for the taxable year.

(d) *Maximum Credit for other Taxpayers.* — In the case of partnerships, associations, corporations, unincorporated businesses or any other taxpayer, the maximum dollar amount allowable as tax credits for qualified educational expenses incurred or paid for all students and scholars shall not exceed fifty percent of the income or franchise tax payable for the taxable year.

Sec. 2. Definition of Terms. — For purposes of this section: (a) The term "educational institution" shall mean any institution, public or private, enrollment at which constitutes compliance with the Compulsory School Attendance Law of the District of Columbia, and which maintains racially nondiscriminatory policies as required by law.

(b) The term "eligible scholar" shall mean any District of Columbia resident who is enrolled on a full-time basis in an educational institution.

(c) The term "eligible student" shall mean any District of Columbia resident who is enrolled on a full-time basis in an institution of higher learning.

(d) The words "fiscal year" mean an accounting period of twelve months ending on the last day of any month other than December.

(e) The term "income and franchise taxes" means any taxes imposed upon a taxpayer pursuant to this Act, or similar taxes upon income of the taxpayer, regardless of the authority for their enactment.

(f) The word "individual" means all natural persons, whether married or unmarried.

(g) The term "institution of higher learning" shall mean any public or private junior college, college, university, professional school or similar institution which requires a high school degree, or its equivalent, as a condition of admission, and which maintains racially nondiscriminatory policies as required by law.

(h) The word "person" means an individual, a partnership (other than an unincorporated business), an association, an unincorporated business, and a corporation.

(i) The term "qualified educational expenses" means sums paid by a taxpayer on behalf of eligible scholars for tuition and other educa-

tional fees actually charged by institutions of higher learning in which such students are enrolled, and for incidental expenses incurred for an in connection with attendance by the eligible scholars or students in such institutions. For other than individual taxpayers, educational expenses must qualify in accordance with the requirements of Section 2 (i) and be provided directly or indirectly to students and scholars who demonstrate financial need in accordance with standards to be enacted by the Council of the District of Columbia.

(j) The words "taxable year" mean the calendar year or the fiscal year upon the basis of which the net income of the taxpayer is computed under this Act; if no fiscal year has been established by the taxpayer, the taxpayer has elected the calendar year. The phrase "taxable year" includes, in the case of a return made for a fractional part of a calendar or fiscal year, under the provisions of this Act or under regulations prescribed by the Mayor, the period for which such return is made.

(k) The word "taxpayer" means any person required by this Act to pay a tax or file a return or report in the District of Columbia.

Sec. 3. Standards for Private Educational Institutions and Institutions of Higher Learning. — Private institutions shall be presumed to meet the minimum standards required by law concerning instruction, quality of education, ethics, health and safety, and fiscal responsibility, provided the instruction, quality of education, ethics, health and safety, and fiscal responsibility are equivalent to the standard maintained in public schools in the District of Columbia.

Sec. 4. Tax Credit not to be Considered as Federal Assistance to Institution. — No educational institution or institution of higher learning shall, on account of enrolling an eligible scholar or student for whom a tax credit is claimed under this title, be considered a recipient of government financial assistance for the purpose of imposing any legal rule, guideline, order, requirement, or regulation upon such institution or for any other purpose.

Sec. 5. Severability and Savings. — The provisions of this measure are severable, and if any provision, sentence, clause, section or part is held illegal, invalid, unconstitutional or inapplicable to any person or circumstances, such illegality, invalidity, unconstitutionality or inapplicability shall not affect or impair any of the remaining provisions, sentences, clauses, sections or parts of the act or their application. Any act, statute or law inconsistent with the provisions of this measure is hereby repealed to the extent of such inconsistency.

Sec. 6. Effective Date. — This measure shall become effective in accordance with Section 5 of Public Law 95-526, Sec. 1(3), amending the Initiative, Referendum, and Recall Charter Amendment Act of 1977 (D.C. Law 2-46), and Section 602(c) of the District of Columbia Self-Government and Governmental Reorganization Act, and shall

apply to taxable years ending on or after December 31, 1982 with respect to qualified educational expenses incurred or actually paid during or after taxable year 1982.

**Summary Statement of the
National Taxpayers Union on the
Proposed D.C. Educational Tax Credit Initiative**

1. A \$1,200 maximum credit per student, to be used against D.C. income taxes, may be taken in any given year.
2. Students benefited may be enrolled in elementary, secondary, post-secondary, or other similar programs.
3. Students benefited need not be related to the taxpayer.
4. Individual taxpayers may consume their entire D.C. income tax liability with educational tax credits, subject to the \$1,200 per student maximum. Corporations may also support the education of as many students as they wish under the tax credit's provisions (subject to the \$1,200 ceiling each), but may consume only up to 50% of their D.C. corporate tax liability with such credits.
5. "Educational expenses" may include but are not limited to tuition and/or fees. Educational expenses are broadly defined to include non-institutional and quasi-institutional educational alternatives as well as the currently widespread institutional ones.
6. At a minimum, the D.C. government will be required to refrain from impairing the even handed application of the education tax credit by further restricting existing educational alternatives via accreditation or other public-school "protective" legislation.

Implementation

The design and intent of the tax credit is to encourage the spirit and practice of mutual aid on an individual and community level. Implementation of the education tax credit will free up substantial sums for improving educational opportunities in the District of Columbia since the amount of available funds will far exceed the number of children who will be in a position to use the funds.

The flexible design of the tax credit makes it possible for givers and beneficiaries to "link up" in any number of ways, and how they do so will depend upon their preferences. It is safe to assume, however, that a great many taxpayers, both individual and corporate, will prefer to see some portion of their present D.C. income tax payments spent to achieve a known good such as education rather than let the money disappear into the bottomless pit of the D.C. Treasury. Since such giving is economically costless to them — taking the tax credit involves no loss of other tax benefits — the incentives for financing a wide variety of educational choices are unobstructed.

Three possible ways to do this are: 1) the taxpayer can give to a United Way or some other voluntary social welfare organization and the organization can distribute the money among the requisite number of students, either directly or indirectly; 2) the taxpayer can give to a school and the school can distribute the money in the form of scholarships either directly or indirectly to the students; 3) the taxpayer can give directly to personally chosen students.

Since the United Way-type organizations are currently in existence, and they are capable of accommodating the informational tasks of distributing educational tax credit-inspired gifts in accordance with the \$1,200 per student ceiling, it is highly likely that most giving under the credit will occur by a such organized voluntary social welfare organization. Similarly strong possibilities include local community and/or parent-teacher organizations, unions, etc.

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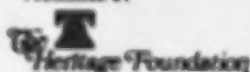
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